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November 14, 2003

The Honorable Magalie R. Salas  
Secretary  
Federal Energy Regulatory Commission  
888 First Street, NE  
Washington, DC 20426

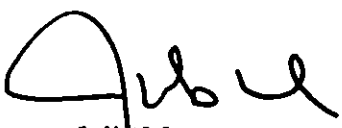
**Re: California Independent System Operator Corporation  
Docket No. EL04-24-000**

Dear Secretary Salas:

Enclosed for filing please find an original and fourteen (14) copies of the Petition for Review of Arbitrator's Award of the California Independent System Operator Corporation.

Two additional copies of this filing also are enclosed. Please stamp these copies with the date and time of filing and return them with our messenger. Thank you for your assistance in this matter.

Sincerely,



Julia Moore

Counsel for the California Independent System  
Operator Corporation

**ORIGINAL**

**UNITED STATES OF AMERICA  
BEFORE THE  
FEDERAL ENERGY REGULATORY COMMISSION**

California Independent System            )  
Operator Corporation                    )       Docket No. EL04-\_\_\_\_-000

**PETITION FOR REVIEW OF ARBITRATOR'S AWARD**

Pursuant to Rule 207 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.207, the California Independent System Operator Corporation ("ISO") petitions the Commission to initiate a proceeding for review of the Final Order and Award ("Award") issued on October 23, 2003, in American Arbitration Association Case No. 71 Y 198 00420 1. San Diego Gas & Electric Company ("SDG&E") initiated the arbitration under Section 13 of the ISO Tariff. The ISO is entitled to Commission review of the Award under Section 13.4 of the ISO Tariff. The ISO further petitions the Commission to establish a procedural schedule for such review. A copy of the Award is attached.

**I. CONSIDERATIONS WARRANTING COMMISSION REVIEW**

This Petition presents fundamental issues concerning the ability of the ISO, as Control Area Operator, to fulfill its responsibility to maintain the reliability of the electric system within its Control Area<sup>1</sup> and to pass on the attendant costs to the beneficiaries of that reliability in a manner that is fair, nondiscriminatory, and consistent with its Tariff. At issue is whether the ISO may charge SDG&E for Transmission Losses on Schedules that SDG&E submits for facilities that are

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<sup>1</sup> Capitalized terms not otherwise defined herein have the meaning set forth in the ISO Tariff Master Definitions Supplement, Appendix A.

within the ISO Control Area according to the terms of the Commission-approved ISO Tariff.

Specifically, SDG&E submits Schedules for the Southwest Power Link ("SWPL") pursuant to Existing Contracts between SDG&E and the two other owners of SWPL, Arizona Power Service Company ("APS") and Imperial Irrigation District ("IID").

SDG&E has argued, and the Arbitrator has held, that the proper amount due to the ISO for the losses attributable to the APS and IID SWPL schedules is the amount calculated pursuant to the Existing Contracts. It is the ISO's position, however, that the ISO Tariff provisions for calculating losses, and for determining what entities are responsible for losses incurred under Existing Contracts, establish definitively that SDG&E is the responsible party, and that the amount to be paid is that calculated under the ISO Tariff (which exceeds the limited losses recognized in the Existing Contracts and which SDG&E has paid since the ISO went into operation).

The ISO uses the same method to calculate SWPL losses as it uses to calculate losses for all its transmission paths, and there is no basis for calculating losses on SWPL any differently than other transmission lines or for providing SDG&E with unfairly favorable treatment. Indeed, the ISO Tariff includes no provision whereby the ISO would treat schedules submitted by SDG&E differently for loss calculations. Therefore, the Commission should allow this appeal to ensure that the ISO Tariff is applied in a uniform and nondiscriminatory manner.

Further, ensuring that costs are fairly shared among beneficiaries is one of the Commission's most fundamental responsibilities. Allowing more favorable treatment for SDG&E in the area of Transmission Losses would result in other entities that participate in the ISO paying a disproportionately higher share of the costs involved. The Award would cause the cost of losses incurred as a result of transactions scheduled by SDG&E on behalf of APS and IID to be borne by other Market Participants. This cost shift, if it is permitted to occur, should take place only after full consideration of these issues by the Commission.

Another fundamental responsibility of the Commission is to promote public health and safety with regard to the transmission of electric power in interstate commerce. See, e.g., 16 USC 824a. The Award as written is adverse to that interest and could impair the safe and reliable operation of the system because it would apportion the length of the SWPL transmission line horizontally and place the divided portions in different Control Areas and subject to different operational control, even though the line would remain physically whole. The Commission should consider the regulatory and operational ramifications of that approach.

In addition, the Award is directly at odds with Orders 458 (*Pacific Gas and Electric Company, et al.*, 100 FERC ¶ 61,156 (2002)) and 458-A (*Pacific Gas and Electric Company, et al.*, 101 FERC ¶ 61,151 (2002)). The Commission should consider this appeal in order to ensure that the ISO Tariff is applied to the allocation of the costs of losses in a manner consistent with those orders.

Finally, the Commission should consider appeal of this matter because the arbitration decision is inherently and fundamentally flawed. The findings and

conclusions set forth in the Award are contrary to the weight of the record evidence, are unsupported by any evidence whatsoever, contravene and fail to consider Commission decisions directly on point, and undercut the safe and reliable operation of the system. The errors are pervasive and warrant review.

## **II. BACKGROUND**

### **A. Factual Background**

The ISO is a non-profit public benefit corporation with centralized control of and responsibility for ensuring the efficient use and reliable operation of a state-wide transmission grid. Cal. Pub. Utility Code § 345. California's three major investor owned utilities – SDG&E, Pacific Gas and Electric Company (“PG&E”), and Southern California Edison Company (“SCE”) – which previously had operated their own transmission systems became Participating Transmission Owners (“Participating TOs” or “PTOs”) in March 1998. They each signed the Transmission Control Agreement (“TCA”) pursuant to which they transferred to the ISO Operational Control, but not ownership, of those transmission facilities in which they had an ownership interest or to which they had legal Entitlements (*i.e.*, contractual user rights). The Control Areas of the three major utilities were then combined to establish the ISO Control Area.

In accordance with its Tariff, the ISO transacts business only through “Scheduling Coordinators” (or “SCs”). Thus, a load serving entity that wishes to use the ISO Controlled Grid to receive electricity from a generator in order to serve its customer demand or “load” must use a Scheduling Coordinator. See generally ISO Tariff §§ 2.2.1, 2.2.3 (Original Sheets No. 2 and 5). Scheduling

Coordinators are the entities that directly interface with the ISO and that are financially responsible to settle transactions in the ISO markets. See generally ISO Tariff § 2.2.6 (Original Sheet No. 13).

Because electricity cannot be stored, safe and reliable operation of the grid requires the ISO to ensure that the supply of electricity and the load on the system is in balance at all times. Scheduling Coordinators are required to submit "balanced" schedules to the ISO in the Day-Ahead and Hour-Ahead Markets. To the extent that supply or load deviates from the scheduled amounts during real-time operations, the ISO must bring supply and load back into balance either by procuring additional energy (in the event that load is higher or supply is lower than scheduled) or by instructing generators to decrease output (in the event that load is lower or supply is higher than scheduled). The ISO then assigns financial responsibility for these real-time transactions to the appropriate Scheduling Coordinators based on meter data that indicates which Scheduling Coordinators were responsible for the unscheduled deviations.

Transmission Losses are one factor that may cause unscheduled deviations to occur. Transmission Losses describe the Energy that is naturally lost through forces of resistance as electricity travels through a transmission line. If a Scheduling Coordinator needs 100 megawatts of electricity to serve load at one end of the line, it must schedule generation of more than 100 megawatts at the other end of the line because some portion of the energy will be lost during transmission due to line losses. If the ISO must procure energy during real-time operations to cover these losses, the ISO must charge the responsible

Scheduling Coordinator for such procurement pursuant to a formula provided in Section 7.4 of the ISO Tariff (Original Sheet No. 213).

The Southwest Power Link, or "SWPL," is a 500 kV transmission line that until last year ran from SDG&E's Miguel Substation to the Palo Verde Nuclear Power Plant switchyard in Arizona. Currently, the line runs from Hassayampa Substation adjacent to the Palo Verde switchyard to the Miguel Substation. SWPL is located entirely within the ISO Control Area. At one time SWPL was owned entirely by SDG&E, but in the early 1980s SDG&E transferred portions of SWPL to Arizona Public Service Company ("APS") and Imperial Irrigation District ("IID"), so that SWPL is now jointly owned by SDG&E, APS, and IID.<sup>2</sup>

SDG&E transferred Operational Control of its transmission facilities and Entitlements to the ISO in 1998 as part of California's electric market restructuring. SDG&E provided the ISO with registry data for the ISO's official record of facilities turned over to the Operational Control of the ISO. This registry data included every component of SWPL from the Palo Verde switchyard in Arizona to the Miguel Substation in East San Diego County. SDG&E listed, as it was required to do, its Existing Contracts (*i.e.*, Participation Agreements) with APS and IID as Encumbrances affecting the ISO's Operational Control of SWPL (meaning that the ISO must respect the scheduling entitlements of APS and IID when operating the line). SDG&E also has signed a Scheduling Coordinator

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<sup>2</sup> The segment of SWPL from Palo Verde to North Gila is owned by SDG&E, APS and IID in shares of 76.22%, 11% and 12.78%, respectively. The North Gila to Imperial Valley segment is owned by SDG&E and IID in shares of 85.64% and 14.36%. The remaining segment from Imperial

Agreement with the ISO pursuant to which it obligated itself to comply with the ISO Tariff and to pay the charges provided for in the ISO Tariff. *See also* ISO Tariff § 2.2.6.1 (Original Sheet No. 13).

Prior to the formation of the ISO, SDG&E served as Control Area Operator for SWPL and was responsible for scheduling the APS/IID transactions on SWPL. Pursuant to the terms of its Participation Agreements with APS and IID, SDG&E received energy from APS and IID to compensate it for Transmission Losses attributed to the APS/IID transactions on SWPL. The amount of energy needed to cover these Transmission Losses was calculated pursuant to a formula contained in the Participation Agreements.

Subsequent to SDG&E's transfer of its transmission facilities and Entitlements to the ISO's Operational Control, SDG&E has submitted schedules to the ISO for transactions on SWPL, including the portion of the capacity owned by APS and IID. The ISO determines losses according to the methodology discussed above. SDG&E receives daily settlement statements from the ISO showing the charges that the ISO is imposing on SDG&E for energy procured to cover Transmission Losses in connection with the APS/IID transactions on SWPL. SDG&E has been paying these charges as calculated under the ISO Tariff since the beginning of ISO operations in March 1998.

Section 2.4.4.4.5 of the ISO Tariff provides as follows:

Parties with Existing Rights shall continue to pay for Transmission Losses or Ancillary Services requirements in accordance with such Existing Contracts as they may be modified or changed in accordance with the terms of the Existing Contract. Likewise the Participating TOs shall continue to provide Transmission Losses

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Valley to Miguel is owned solely by SDG&E. The entire line is in the ISO Control Area.



and any other Ancillary Services to the holder of the rights under an Existing Contract as may be required by the Existing Contracts. To the extent that Transmission Losses or Ancillary Service requirements associated with Existing Rights are not the same as those under the ISO's rules and protocols, the ISO will not charge or credit the Participating TO for any cost differences between the two, but will provide the parties to the Existing Contracts with details of its Transmission Losses and Ancillary Services calculations to enable them to determine whether the ISO's calculations result in any associated shortfall or surplus and to enable the parties to the Existing Contracts to settle the differences bilaterally or through the relevant TO Tariff.

Under this provision of the ISO Tariff, SDG&E would have been able to recover the difference between the transmission costs assessed it by the ISO and those collected under its Existing Contracts with APS and IID through its TO Tariff. In an Initial Decision issued on September 1, 1999, however, the Administrative Law Judge concluded that Participating TOs should not be able to recover such differences through their TO Tariffs. *Pacific Gas and Electric Company, et al.*, 88 FERC ¶ 63,007 (1999) at 65,051-52. SDG&E commenced this dispute resolution process following the, Initial Decision, which was affirmed in Orders No. 458 (*Pacific Gas and Electric Company, et al.*, 100 FERC ¶ 61,156 (2002)) and 458-A (*Pacific Gas and Electric Company, et al.*, 101 FERC ¶ 61,151 (2002)).

## **B. Procedural Background**

Following a period of Good Faith Negotiations with the ISO, SDG&E filed a Statement of Claim against the ISO under Section 13.2.2 of the Tariff on July 6, 2001. In its Statement of Claim, SDG&E made the following claims against the ISO:

1. that the ISO's formula for allocating Transmission Losses is unfair and inconsistent with the allocation formula contained in a private contract between SDG&E on the one hand and the APS and the IID on the other. SDG&E contended that the allocation formula contained in its private contract resulted in a more accurate allocation of Transmission Losses than did the allocation formula contained in the ISO Tariff. SDG&E further contended that it was the intent of the Tariff to honor contractual agreements, including the allocation formula contained in the SDG&E contract.
2. that even if the ISO were permitted to use the allocation formula set forth in the Tariff, the ISO had misapplied the Tariff by allocating to SDG&E Transmission Losses occurring on a portion of the transmission line for which operational control had not been given to the ISO.
3. that the ISO had been misallocating certain Transmission Losses in the wake of Amendment No. 33 to the ISO Tariff and that while the ISO had corrected the problem prospectively, the ISO refused to reallocate those costs on a retroactive basis.

On August 3, 2001, the ISO filed a Response to Claim. In its Response to Claim, the ISO denied the material allegations of SDG&E's Statement of Claim and further denied that SDG&E had been damaged by any act or omission of the ISO. Specifically, the ISO's response to SDG&E's claims was as follows:

1. The ISO denied that it had breached any contractual or Tariff provision. To the contrary, the ISO stated that it had applied the applicable Tariff provisions according to their plain meaning. Indeed, the ISO stated that that it would have been a breach of the applicable Tariff provisions for the ISO to allocate Transmission Losses by the methodology advanced by SDG&E. The ISO further denied that SDG&E had been damaged in any amount as a result of any unlawful act or omission of the CAISO.
2. The ISO denied that it had in any way wrongfully deprived SDG&E of the benefits of any contractual agreement or Tariff entered into between SDG&E and the ISO. The ISO stated that it had at all times dealt with SDG&E in good faith and according to the plain language of the Tariff.
3. The ISO denied that its administration of its Tariff was unjust, unreasonable, or unduly discriminatory or that it had charged SDG&E for any "improper Amendment 33 penalties." The ISO stated that it was in the process of reallocating Imbalance Energy charges in the wake of

Amendment No. 33, and that it would make retroactive adjustments as appropriate. The ISO sought a declaration that it had applied its Tariff properly and that the methodology used by the ISO in reallocating Imbalance Energy charges in the wake of Amendment No. 33 was appropriate.

4. The ISO denied that it had engaged in any unlawful, unfair or deceptive business practice. The ISO stated that it had at all times acted reasonably in responding to concerns raised by SDG&E. The ISO denied that SDG&E would be entitled to any form of equitable relief based upon any alleged unfair business practice.
5. The ISO denied that it had breached any fiduciary duty to SDG&E, if such duty even were owed. The ISO stated that it had at all times acted in good faith towards SDG&E.

Finally, the ISO requested that SDG&E's claims be rejected and that the ISO's allocation and assessment of Transmission Loss costs to SDG&E in conformance with the ISO Tariff be confirmed.

The Arbitrator was appointed on March 13, 2002, and a procedural schedule was proposed jointly by the parties and approved by the Arbitrator on April 2, 2002. Written direct testimony was submitted by SDG&E on May 3, 2002, and by the ISO on May 28, 2002. SDG&E filed prepared rebuttal testimony on June 12, 2002.

Although the matter initially was scheduled to proceed to arbitration in June 2002, on May 22, 2002 the ISO moved the Arbitrator, *inter alia*, to stay the proceeding pending the resolution of a related FERC proceeding<sup>3</sup> and the arbitration proceedings in which SDG&E was involved with APS and IID. The Arbitrator granted this motion on June 14, 2002. When the procedural schedule

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<sup>3</sup> This proceeding was that of Docket No. ER97-2358, resulting in the Initial Decision and commission orders discussed below.

resumed, the parties filed supplemental testimony on April 4, 2003, and pre-hearing briefs on April 10, 2003.

The arbitration hearing was held in San Francisco, California on April 15 and 16, 2003. Post-hearing briefs were filed on May 21, 2003 and post-hearing reply briefs were filed on August 13, 2003.

### **C. Arbitration Decision**

The Arbitrator issued his Award on October 23, 2003. The Arbitrator awarded SDG&E \$21,253,136.50, which is the difference, including interest, between SDG&E's payments to the ISO for Transmission Losses on the transactions associated with APS and IID and what SDG&E received from APS and IID for losses from March 31, 1998 and December 31, 2002. In addition, SDG&E was awarded the difference in SDG&E's payments to the ISO for these Transmission Losses and what SDG&E received from APS and IID from January 1, 2003 forward, plus any charges paid by SDG&E to the ISO under ISO Account Nos. 407 and 487, plus interest.

Specifically, the Arbitrator concluded that

1. The ISO Tariff limits the ISO Controlled Grid to those facilities that have been placed under the ISO's Operational Control.
2. SDG&E could not and did not transfer Operational Control over the APS and IID shares of SWPL to the ISO; therefore, the APS and IID portions of SWPL are not a part of the ISO Controlled Grid.
3. Since the APS and IID owned portions of SWPL are not a part of the ISO Controlled Grid, Section 7.4 of the ISO Tariff does not apply to energy schedules on their respective shares of the line.
4. Since the APS and IID portions of SWPL are not part of the ISO Controlled Grid, APS and IID are not Market Participants, and SDG&E is

not a Scheduling Coordinator for energy scheduled on the portions of SWPL owned by APS and IID.

5. The ISO exceeded its authority under the ISO Tariff by imposing its transmission loss methodology to transactions on facilities that are not part of the ISO Controlled Grid.
6. SDG&E is not a Scheduling Coordinator for energy scheduled on the APS and IID portions of SWPL and therefore Sections 11.7.2 and 11.7.3 of the ISO Tariff are not applicable to the claims of SDG&E.

### **III. STATEMENT OF ERRORS**

The award is contrary to or beyond the scope of relevant ISO documents, in particular the ISO Tariff and Protocols, Federal law, Commission regulations or decisions, or state law for a number a reasons, including, but not limited to, the following:

1. The Arbitrator's conclusion that the ISO is prohibited from assessing losses to SDG&E occurring on portions of SWPL that are identified as Encumbrances in the Transmission Control Agreement renders Section 2.4.4.4.5 and Scheduling Protocol 4.3 of the ISO Tariff surplusage and is thus an impermissible construction of the ISO Tariff. This construction also is contrary to Orders No. 458 and 458-A in that it provides precisely the relief precluded those orders.

2. The Arbitrator erroneously conflated ownership with Operational Control. The fact that APS and IID owned undivided interests in portions of SWPL did not preclude SDG&E from having Operational Control over SWPL or from turning over that Operation Control to the ISO.

a. The Arbitrator erroneously equated Operational Control, as defined in the ISO Tariff,<sup>4</sup> with the ability to direct the manner in which entities schedule Generation and Load.

b. Contrary to the Arbitrator's conclusions, the evidence clearly establishes that SDG&E turned over Operational Control of the entirety of SWPL to the ISO, subject to the capacity Entitlements of APS and IID.<sup>5</sup>

3. The Arbitrator's conclusion that SDGE is not the Scheduling Coordinator for the energy schedule on the portions of SWPL owned by APS and IID is not supported by the language of the ISO Tariff or by substantial evidence. SDG&E's Scheduling Coordinator Agreement does not include any limitations on its responsibility for the entities for which it agreed to schedule. Furthermore, SDG&E has accepted Scheduling Coordinator responsibility by its course of conduct. Moreover, there is no other basis for the ISO to accept schedules from SDG&E on behalf of APS and IID than that SDG&E is their Scheduling Coordinator.<sup>6</sup>

4. The Arbitrator erred in concluding that Sections 11.7.2 and 11.7.3 of the ISO Tariff do not bar SDG&E's belated claims because of the Arbitrator's substantive conclusion that SDG&E is not the Scheduling Coordinator for

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<sup>4</sup> In the ISO Tariff, Operational Control is defined as: "The rights of the ISO under the Transmission Control Agreement and the ISO Tariff to direct Participating TOs how to operate their transmission lines and facilities and other electric plant affecting the reliability of those lines and facilities for the purpose of affording comparable non-discriminatory transmission access and meeting Applicable Reliability Criteria."

<sup>5</sup> If the Award is enforced, and the determination that the non-SDG&E elements of SWPL are not under ISO Operational Control is upheld, then this would have substantial negative impact on the operation of the ISO system.

<sup>6</sup> Should the Award be enforced in this regard, the ISO would no longer be able to accept schedules from SDG&E on behalf of APS and IID.

SDG&E. Even if the Arbitrator's substantive conclusions were correct, the applicability of Sections 11.7.2 and 11.7.3, which specify period in which claims must be brought, does not depend upon the merits of a claim.

5. The findings and conclusions set forth in the Award are contrary to the weight of the record evidence, are unsupported by any evidence whatsoever, contravene and fail to consider Commission decisions directly on point, and undercut the safe and reliable operation of the system.

Section 13.4.1 of the ISO Tariff authorizes an appeal of an Arbitration Award on these grounds.

#### **IV. REQUEST FOR PROCEDURES**

Article 13.4 of the ISO Tariff provides for appeals from an arbitrator's award. It requires that the appealing party provide notice to the participants in the arbitration within 14 days of the award. The ISO provided such notice on November 6, 2003. It further requires that the appealing party make an appropriate filing with the Commission to trigger review within 10 days of the notice to parties and file the record with the Commission within 30 days of the notice, unless the Commission orders otherwise.

Although the ISO Tariff provides no guidance as to the nature of the document to be filed to trigger Commission review or as to the procedures that follow such filing, petitions previously have been filed pursuant to the ISO Tariff in Docket Nos. EL02-45 and EL03-54. Consistent with the procedures followed in those dockets, the ISO files this document in the form of a Petition for Review, and requests that the Commission establish a briefing schedule for review of the

Arbitrator's Award that will allow all parties to fully present to the Commission their arguments against and in support of the Award. Section 13.4.2 of the ISO Tariff provides that the appeal will take place on the record as it existed before the arbitrator (except in the event of new legal authority or an allegation of fraud or similar misconduct). Therefore, review can occur through briefing with citations to the record.

SDG&E and the ISO have agreed to propose the following schedule jointly to the Commission:

ISO and supporting intervenors' Initial Briefs	January 6, 2004
SDG&E and supporting intervenors' Answering Briefs	January 30, 2004
ISO and supporting intervenors' Reply Briefs	February 12, 2004

## **V. SERVICE**

The ISO is serving the petition on the parties to the arbitration, as well as the Public Utilities Commission of the State of California and the California Electricity Oversight Board. The ISO is serving the Arbitrator via e-mail. Notice of the appeal was previously posted on the ISO Home Page.



**VI. CONCLUSION**

The ISO therefore requests that the Commission initiate a proceeding for the review of the Award and establish procedures and a procedural schedule for that review.

Respectfully submitted,



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Counsel for the California Independent  
System Operator Corporation

Dated: November 14, 2003

**ATTACHMENT A**

**AMERICAN ARBITRATION ASSOCIATION  
COMMERCIAL ARBITRATION TRIBUNAL**

**In the Matter of the Arbitration between**

**SAN DIEGO GAS & ELECTRIC COMPANY, a  
California Corporation**

**Claimant**

**V.**

**No. 71 Y 198 00420 1**

**CALIFORNIA INDEPENDENT SYSTEM OPERATOR,  
a California Nonprofit Benefit Corporation.**

**Respondents**

**ADMINISTRATOR: Jeremy T. Jackson**

**AWARD OF ARBITRATOR**

**I, THE UNDERSIGNED ARBITRATOR having been designated in accordance with the procedures of the Commercial Arbitration Rules of the American Arbitration Association and having been duly sworn and having duly heard the proofs and allegations of the parties hereby, AWARD, as follows:**

**INTRODUCTION**

**Claimant, San Diego Gas & Electric Company initiated this arbitration proceeding on July 6, 2001. The Respondent, California Independent System Operator, responded to the arbitration claim on August 3, 2001. The Arbitrator was appointed on March 13, 2002. A procedural schedule was jointly proposed by the parties and approved by the Arbitrator on April 2, 2002. The parties thereafter submitted written direct testimony of their witnesses and a hearing was held in San Francisco, California on April 15 and 16, 2003 at which time the witnesses were cross examined on their written direct testimony.**

Post hearing briefs were filed. Claimant requested that the record be supplemented and the request was granted. A final argument was telephonically conducted on September 12, 2003. The record was formally closed on September 17, 2003 following receipt of the transcript of the final argument. Counsel for both parties have done an outstanding job of effectively and efficiently presenting the positions of their clients. The clients have been well served.

The issues in this proceeding arise from legislative changes in the California electric utility regulatory design. The design changed from a fully regulated monopolistic system to one where regulated competition is now permitted. The issues in this matter arise from those changes.

Under the former regulatory design, electric utilities were required to make the investments and contracts necessary to serve the customers in their service territory. In return, the electric utilities were permitted the opportunity to earn a regulated return on the investments made to serve those customers. Those investments and many contracts required the approval of the appropriate regulatory bodies. This design was commonly referred to as the "regulatory compact." The new design, as applicable here, permits competitive generation and non-discriminatory access to transmission.

With any new legislation, there are always a number of things that must be worked out in the implementation of the new law. Electric deregulation in California required many changes in the way California utilities operated. The new legislation acknowledged those changes would affect existing commitments and contracts, but required that existing contracts be recognized and accommodated.

CALISO was created to fulfill a specific responsibility. The ISO Tariff which governs CALISO's activities and the activities of those it serves is very comprehensive, but with any document of this magnitude, there are areas where disagreements arise over coverage and application. In this case, CALISO appears to have chosen an interpretation of the facts in and OF the ISO Tariff with which the Arbitrator cannot agree. The facts, language of the ISO Tariff and the policy of the legislation require an award to SDG&E.

Any suggestion that the claim in this case should be denied because it is somehow offset by other benefits of deregulation is without merit. This conclusion is supported by the policy of the law which requires that existing contractual rights be recognized and accommodated. There is no reason that the provisions of the preexisting contracts at issue in this matter should not be

accommodated by CALISO. The Arbitrator recognizes that it may take some effort to spread the cost of this award to the appropriate customers, but unless that is done, the shareholders of SDG&E may have to bear the costs of the change in the law and its affect on the contracts in question.

While there are many issues that arise from such legislative and regulatory changes, participants in the system should not be required to try and guess which is the proper way to have the system reflect the proper cost allocation. The costs in question in this matter have been the subject of litigation in various forums for several years. This award should resolve the issues in this case once and for all.

Both Claimant and Respondent have advised the Arbitrator that no matter what decision the Arbitrator makes, the party receiving the adverse decision will appeal this Award to the Federal Energy Regulatory Commission. Such an appeal is permitted by law. The Commission will base its decision upon the record established in this arbitration proceeding which made it very important that this record be complete to avoid the need for FERC to return the matter to the Arbitrator for additional testimony.

### FINDINGS OF FACT

#### Parties

1. San Diego Gas & Electric Company (hereinafter "SDG&E") is a California corporation with its principal place of business at 8330 Century Park Court, San Diego, California. SDG&E is the Claimant in this proceeding 92123.

2. The California Independent System Operator Corporation (hereinafter "CALISO") is a nonprofit public benefit corporation organized under California law with its principal place of business at 151 Blue Ravine Road, Folsom, California 95630.

#### Ownership and Operation of the Southwest Power Link (SWPL)

3. The Southwest Power Link (hereinafter "SWPL") is a 292 mile, 500 kV transmission line from, until last year, Palo Verde Nuclear Generating Station switchyard in Arizona to the Miguel Substation of SDG&E in San Diego County, California. SWPL currently runs from Hassayampa Substation which is adjacent to the Palo Verde switchyard.

4. SWPL interconnects to the Arizona Public Service Company (hereinafter "APS") control area at the North Gila Substation near Yuma, Arizona and to the Imperial Irrigation District (hereinafter "IID") control area at the Imperial Valley Substation in California. The current transfer rating of SWPL, as recognized by the Western Electricity Coordinating Council (hereinafter "WECC") is 1,273 MW from Palo Verde to North Gila and 1,331 MW from North Gila to Miguel.

5. Under the terms of contracts entered into in 1981 and 1983 (hereinafter "Participation Agreements"), SDG&E transferred undivided interests in portions of SWPL to APS and IID. A June 24, 1981 agreement referred to as the "Arizona Participation Agreement", transferred to APS an undivided interest in the segment of SWPL from Palo Verde to North Gila. Two agreements entered into on May 1, 1983, known as the "California Participation Agreement" and the Arizona Transmission System Assignment of Interests" transferred to IID undivided interests in the North Gila Imperial Valley and Palo Verde North Gila sections of SWPL.

6. With the transfers of ownership under the Participation Agreements, SWPL is owned jointly by SDG&E, APS, and IID. The ownership shares vary on the three segments of the line as follows: the Palo Verde-North Gila segment is owned by SDG&E, APS and IID in shares of 76.22%, 11% and 12.78% respectively; the North Gila-Imperial Valley segment is owned by SDG&E and IID in shares of 85.64% and 14.36% respectively. The Imperial Valley-Miguel segment is 100% owned by SDG&E.

7. APS and IID control the use of their respective portions of SWPL. APS and IID do not serve load in the ISO Controlled Grid or in the ISO Control Area, nor do they rely on the energy markets of CALISO to serve that load. APS uses its portion of SWPL to deliver energy it acquires to load at its North Gila Substation. IID uses its portion of SWPL to deliver energy it acquires to load in the Imperial Valley at the Imperial Valley Substation. These loads served by APS and IID by means of SWPL lie in their own respective control areas and not in the control area of CALISO. Under the Participation Agreements, SDG&E is assigned to coordinate schedules on SWPL to meet the North American Electric Reliability Council and WECC reliability requirements. The Participation Agreements define this coordination role as "Scheduling Agent" and requires SDG&E, subject to prudent operating practices to implement the energy schedules provided to it by APS and IID for their respective portions of the line.

8. The Participation Agreements provide that SDG&E and APS share responsibility for the physical operations of SWPL. The Arizona Participation Agreement provides that APS is the operator of SWPL in Arizona between North

Gila and the Palo Verde Switchyard. Although SDG&E is responsible for coordinating energy schedules on the entire line, APS is responsible under the Arizona Participation Agreement for actual physical operation, (switching and maintenance) of the SWPL transmission facilities in Arizona. The California Participation Agreement provides that SDG&E is to serve as the operator of the SWPL facilities in California.

9. The Participation Agreements also provide that if an owner of SWPL capacity does not use that capacity, the co-owners may use the unused capacity on a non-firm basis.

#### Formation of CALISO

10. As part of the restructuring of the California electricity market, CALISO was formed to insure efficient, reliable, and non-discriminatory operation of the electric transmission grid throughout most of California. The legislation and orders directing the creation of CALISO also directed SDG&E, Southern California Edison Company (hereinafter "SCE") and Pacific Gas & Electric Company (hereinafter "PG&E") (jointly, "Participating TOs") to transfer control over, but not ownership of, their respective transmission systems to CALISO.

11. Transfer of control of the transmission systems to CALISO was accomplished through the execution of a Transmission Control Agreement (hereinafter "TCA") with the Participating TOs, including SDG&E. The Participating TOs also sought Federal Energy Regulatory Commission (hereinafter "FERC") authorization for the transfer under section 203 of the Federal Power Act. FERC authorized the transfer in *Pacific Gas & Electric Co., et al*, 81 FERC 61,122 (1997). Other than the TCA, as approved by FERC, no other legislative, regulatory or contractual provision appears to provide for the transfer of Operational Control of public utility facilities to CALISO.

12. In accordance with the TCA signed by SDG&E and the FERC authorization, CALISO assumed control of the facilities transferred by SDG&E as of March 31, 1998, the CALISO operations date.

13. APS and IID did not execute a TCA with CALISO. APS and IID did not apply to FERC to transfer control of their share of SWPL to CALISO.

14. The TCA provides CALISO with "Operational Control" over the transferred facilities. The TCA defines "Operational Control" as

The rights of the ISO under the Transmission Control Agreement and the ISO Tariff to direct Participating TOs how to operate their

transmission lines and facilities and other electric plant affecting the reliability of those lines and facilities for the purpose of affording comparable non-discriminatory transmission access and meeting Applicable Reliability Criteria.

15. The TCA describes the facilities that are to be placed under Operational Control of CALISO in Appendices. Appendix A lists the facilities and Entitlements of the transmission owner over which CALISO will assume Operational Control. Entitlement is defined in the CALISO Tariff as "the right of a Participating TO obtained through contract or other means to use another entity's transmission facilities for the transmission of Energy". Appendix B lists any Encumbrances to the transferred facilities. An Encumbrance is defined as

A legal restriction or covenant binding on the Participating TO that affects the operation of any transmission lines or associated facilities and which the ISO needs to take into account in exercising Operational Control over such transmission lines or associated facilities if the Participating TO is not to risk incurring significant liability.

16. In Appendix A to the TCA, SDG&E pictured SWPL with the Palo Verde-North Gila and North Gila-Imperial Valley segments, the segments that are less than 100% owned by SDG&E, as being "co-owned".

17. SDG&E also listed the Participation Agreements as "Encumbrances" in Appendix B on SDG&E's interest in SWPL, specifying each co-owner's share in the scheduling rights on the line. Because the Participation Agreements provided SDG&E with non-firm rights on the APS and IIS shares of SWPL, SDG&E listed the contracts as "Entitlements" in Appendix A, again listing each co-owner's scheduling rights. The Participation Agreements were listed because APS and IID, under their respective contracts, have first claims on any SWPL capacity owned, but not used, by SDG&E. SDG&E has corresponding rights on SWPL capacity owned, but not used, by its two co-owners.

18. The designation of SWPL as "co-owned" in Appendix A and the inclusion of the Participation Agreements in Appendices A and B made it clear that SDG&E was not transferring Operational Control over the APS and IID shares of SWPL.

19. On the day CALISO assumed Operational Control of the SDG&E facilities transferred by the TCA (March 31, 1998), SDG&E in a letter told CALISO that it was "transferring Operational Control only for that portion of the SWPL that it owns." A chart was attached to the letter specifying again the



respective ownership shares of the three owners in each segment of SWPL, as well as their secondary rights to unused capacity on each others' shares. CALISO responded on April 6, 1998, acknowledging the shared ownership of SWPL and indicated that it had passed the information on to operations and settlement personnel "so that transactions over the SWPL can be conducted and billed properly."

20. Since CALISO began operations, APS and IID have continued as owners to determine the use of their respective shares of SWPL. APS and IID do not submit their schedules for approval under the ISO Tariff, and with respect to such schedules, they are not subject to the non-discrimination requirements or access charges of that tariff.

21. APS and IID determine whose energy, at what times, and in what amounts will be carried over their capacity on SWPL; CALISO does not make those determinations. CALISO does not determine how such capacity is used and does not include that capacity in determining how much capacity is available for use by third parties under the ISO Tariff. Under the definition of Operational Control in the ISO Tariff, CALISO cannot and does not direct SDG&E, any other Participating TO, or APS and IID how to operate the APS and IID shares of SWPL "for the purpose of affording comparable nondiscriminatory transmission access."

22. SWPL is not the only jointly owned line over which some, but not all, owners have conveyed Operational Control to CALISO. The same is true of the Mead-Phoenix line, where the Cities of Azusa and other California municipalities, by executing the TCA, have conveyed Operational Control over only their shares to CALISO. The same is also true of the Pacific High Voltage DC line, where SCE and PG&E have done the same. Both lines are outside the CALISO Control Area. Portions of certain jointly owned lines within CALISO's Control Area have not been turned over to CALISO's Operational Control. The California Oregon Transmission Project is an example.

23. The identification of the co-owned portions of SWPL in the Appendices to the TCA by SDG&E was similar to the City of Azusa's identification of the co-owned portions of the Mead-Phoenix line in the TCA. Like the City of Azusa, SDG&E did not evidence an intent to convey to CALISO Operational Control anything other than its own share of SWPL. The identification of the facilities SDG&E was conveying to CALISO was more thorough and detailed than the City of Azusa's identification of the Mead-Phoenix line.

24. CALISO's lack of Operational Control over those portions of SWPL owned by APS and IIS does not affect CALISO's ability to exercise Operational

Control of SDG&E's portion of SWPL. CALISO can exercise Operational Control over a portion of a jointly owned line as demonstrated by its Operational Control over only portions of the Mead-Phoenix and Pacific High Voltage DC lines. The lack of Operational Control over only a part of a jointly owned line does not prevent CALISO from carrying out its Control Area functions for such lines. In fact, certain responsibilities for reliable operation of portions of SWPL east of the Colorado River are assigned to APS rather than CALISO.

Transmission Losses

25. Transmission losses, or line losses, occur when electrical energy is transmitted from the generating source to the consumer. These losses result from the electrical resistance of the conductors transmitting the energy. The location of the generator in relation to the point where the energy is consumed affects the amount of the losses.

26. In the Participation Agreements, SDG&E, APS & IID agreed upon the methodology for computing and allocating transmission losses over SWPL. Under the contracts, losses are not estimated, but are determined according to measurements of actual power flows. APS and IID compensate SDG&E for transmission losses by return of energy to SDG&E in amounts equal to the losses calculated according to the power flow studies.

27. The ISO Tariff uses Generator Meter Multipliers (hereinafter GMMs) to determine the affect of system transmission losses due to incremental, or marginal, injection of generation into the grid by any particular generator or scheduled energy import. Conceptually, this method measures losses at each supplier node by injecting one MW of power at a node and allocating the one MW injection pro rata to all loads in the CALISO system, while taking into account incremental transmission losses. The calculation assumes that generation or energy scheduled on the transmission lines will serve the incremental load spread throughout California proportionally to existing load.

28. The load served by APS and IID over their respective portions of SWPL are located at the southeast extremity of the ISO Controlled Grid. Therefore, the methodology provided in Section 7.4 of the ISO Tariff for calculating transmission losses assigns substantially higher losses than under the methodology in the Participation Agreement, and accordingly higher losses than actually occur.

29. Beginning on March 31, 1998, the operational date of CALISO, it applied the methodology of Section 7.4 of the ISO Tariff to energy scheduled by APS and IID over their respective portions of SWPL, and imposed the result charges on SDG&E.

30. The difference in the way transmission charges are calculated under the Participation Agreements and the ISO Tariff, produced charges to SDG&E by CALISO through December 31, 2002 of \$18,992,007.21 more in loss charges paid to CALISO for energy scheduled by APS and IID over their respective shares of SWPL than it received from APS and IIS as compensation for losses under the respective Participation Agreements. Interest on that figure through February 2003, calculated in accordance with FERC regulations at C.F.R. Section 35.19a(a)(2)(iii), totals \$2,261,129.29

31. The issue of CALISO charges for losses related to energy scheduled over the APS and IIS shares of SWPL have been the subject of disagreement between the parties since March 1998. Since the disagreement could not be resolved, this arbitration proceeding was initiated.

32. Since CALISO began operations, SDG&E has proposed various operational adjustments to eliminate the mismatch between the amounts it received for losses from APS and IID and the amounts for those losses claimed by CALISO. Such adjustments have been opposed by CALISO.

#### CONCLUSIONS OF LAW

1. This matter has been properly submitted for arbitration under Section 3.1.1 of the ISO Tariff.

2. The ISO Tariff limits the ISO Controlled Grid to those facilities that have been placed under the ISO's Operational Control.

3. SDG&E could not and did not transfer to CALISO Operational Control over those portions of SWPL owned by APS and IID. Therefore, the APS and IID portions of SWPL are not part of the ISO Controlled Grid.

4. Since the APS and IID owned portions of SWPL are not part of the ISO Controlled Grid, Section 7.4 of the ISO Tariff does not apply to energy schedules on their respective shares of the line.

5. Since the APS and IID portions of SWPL are not part of the ISO Controlled Grid, APS and IID are not Market Participants, and SDG&E is not a Scheduling Coordinator for energy scheduled on the portions of SWPL owned by APS and IID.

5. CALISO exceeded its authority to under the ISO Tariff by imposing its transmission loss methodology to transactions on facilities which are not part of the ISO Controlled Grid.

6. SDG&E is not a Scheduling Coordinator for energy scheduled on the APS and IID portions of SWPL and therefore Sections 11.7.2 and 11.7.3 of the ISO Tariff are not applicable to the claims of SDG&E. The record does not support any other time bar to these claims such as laches. The SDG&E claim has been the subject of discussion and disagreement since 1998.

**AWARD**

It is hereby ORDERED that SDG&E be awarded the sum of \$18,992,007.21, the difference between what SDG&E paid to CALISO for transmission losses on the APS and IID transactions on SWPL and what SDG&E received from APS and IID for the period March 31, 1998 and December 31, 2002, and the sum of \$2,281,199.29 in interest through December 31, 2002 calculated in accordance with FERC regulations at 18 C.F.R. Section 35.19a(a), the total through December 31, 2002, being \$21,253,136.50.

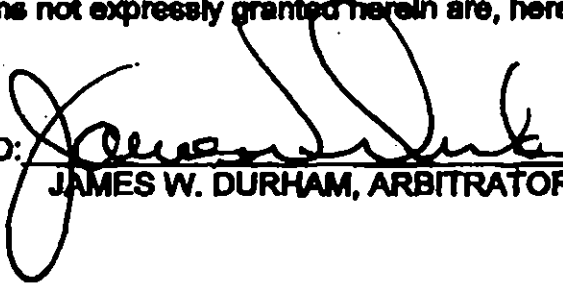
It is FURTHER ORDERED that SDG&E be awarded the costs for the difference between what SDG&E paid to CALISO for transmission losses on the APS and IID transactions on SWPL and what SDG&E received from APS and IID since January 1, 2003, plus any charges under ISO Account Nos. 407 and 487 invoiced by CALISO and paid by SDG&E, together with interest calculated in accordance with FERC regulations at 18 C.F.R. Section 35.19a(a).

It is FURTHER ORDERED that the parties each bear their costs and attorney fees for this proceeding.

It is FURTHER ORDERED that counsel for the parties prepare a stipulated record for the appeal to FERC. Counsel have already agreed to provide this stipulated record.

**The Award is in full settlement of all claims submitted to this Arbitration.  
All claims not expressly granted herein are, hereby denied.**

SIGNED:

A handwritten signature in black ink, appearing to read "James W. Durham", written over a horizontal line.

DATED: October 23, 2003

**JAMES W. DURHAM, ARBITRATOR**

**ATTACHMENT B**



Comment Date: \_\_\_\_\_